FARM FORECLOSURE MORATORIA AND THE CONTRACT CLAUSE: AN ECONOMIC ANALYSIS

Home Building & Loan Association v. Blaisdell, *the 1933 decision upholding Minnesota's moratorium law, is one of the standard cases in modern constitutional texts and casebooks. From one perspective, the decision invites a conventional legal analysis of the meaning of the contract clause and the degree to which the Supreme Court should and does defer to legislative decisions about economic matters, especially during a crisis such as the Great Depression. One supposes that most constitutional teachers are content to discuss these questions, while ignoring the "legislative merits" of moratoria. We think that a broader approach is preferable, so that students become aware of the possibility that* Blaisdell *was a hard case factually as well as legally.*

Those who agree with our pedagogical strategy may wish to peruse the following report, published in response to recent proposals for farm mortgage foreclosure moratoria.

FARM FORECLOSURE MORATORIA: ISSUES AND OPTIONS

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SUMMARY

Minnesota agricultural policymakers have been presented recently with a variety of proposals for farm relief. Foreclosure moratoria represent one set of proposals. This paper discusses the intent and potential effects of three types of moratoria: voluntary nonforeclosure, a conditional moratorium, and a mandatory moratorium. Moratorium proposals generally seek to halt or restrict the rise in farm foreclosures in the state. Another purpose of a state imposed moratorium is to "send a signal" to the federal government that something must be done about farm problems. The economic impacts on farm lenders and farm borrowers are discussed. Indirect effects on the nonfarm rural economy are briefly analyzed.

Farm foreclosure moratoria in the 1930's had adverse effects on credit availability and a modest impact on the rate of farm failures. Economic conditions today are quite different. The analysis suggests that the following economic impacts may result from imposition of farm foreclosure moratoria. The general direction (but not the magnitude) of each change has been deduced. Table 1 summarizes the analysis.

Impacts on farm borrowers. A moratorium allows a farmer to use loaned capital for the period specified by the legislation, whether or not the farmer is making payments on the loan.

1. The flow of funds to the farm sector may be reduced as lenders reallocate resources in an attempt to reduce losses.
2. Interest costs are expected to rise as lenders attempt to maintain earnings at acceptable levels.

3. Some high-risk, creditworthy borrowers will be refused additional credit as lenders reevaluate risk of default.

Impacts on lenders. A moratorium restricts a lender's right to recover capital by foreclosing on nonperforming loans.

1. Lenders will experience a continuation of lower earnings on capital tied-up in nonperforming farm loans.
2. Imposition of a moratorium during a period of declining collateral asset values may result in capital losses. The effects of capital losses on farm lenders will vary due to differences in levels of capitalization and provisions for loss sharing.

Additional impacts.

1. The effects of a moratorium on farm land prices is [sic] uncertain.
2. Moratorium legislation which seals off negotiation possibilities may undermine lender/borrower efforts to develop alternatives to foreclosure.
3. Some lenders may be expected to increase or accelerate foreclosure activities in advance of anticipated moratorium legislation.
4. Moratorium legislation is an effective signal to the extent that the intended signal is received by the appropriate parties.

In summary, a farm foreclosure moratorium would have different effects upon different participants in farm credit markets. It is important that public policy actions be evaluated in light of these differences.

FARM FORECLOSURE MORATORIA: ISSUES AND OPTIONS

I. Intent of a Farm Foreclosure Moratorium

a. The basic intent of a moratorium on farm foreclosures is to stop foreclosure proceedings for a given period (see Appendix 1, Minn. Stat. Ch. 580.02, 1985). Farmers would gain temporary relief from their financial obligations. Also, a signal would be sent to Congress, lenders, borrowers, or others drawing attention to the severity of the financial situation in the agricultural sector. To the extent that the moratorium is an attempt to allow for recovery, relatively rapid improvement in the farm sector (external adjustment) or sufficient improvement in the financial condition of the firm [sic] (internal adjustment)

Table 1. Summary of the Impacts of a Farm Foreclosure Moratorium.

Nonforeclosure	Voluntary Moratorium	Conditional Moratorium	Mandatory Moratorium
(1) *Impact on Lenders*			
(a) Foregone income	potential	potential	yes
(b) Reduction in profits	potential	potential	yes
(c) Reduction in equity capital	potential	potential	yes
(2) *Impact on Borrowers*			
(a) Credit access (farm)	potential reduction	reduction	reduction
(b) Credit access (nonfarm)	potential increase	increase	increase
(c) Credit costs (farm)	potential increase	selective increase	selective increase
(d) Credit costs (nonfarm)	uncertain	uncertain	uncertain
(3) *Impact On Lender/Borrower Relationships*			
(a) Future relationships	potential improvement	uncertain	harmful
(b) Court costs	unlikely to increase	increase	increase
(c) "Buy time"	yes	yes	yes
(4) *Other Impacts*			
(a) Anticipatory foreclosures	none	possible	more likely
(b) Post moratorium foreclosure activity	potential increase	potential increase	potential increase
(c) Legal aspects	few	most complicated	complicated
(d) Compatibility with other actions	major consideration	major consideration	major consideration
(e) Land markets (land prices)	uncertain	uncertain	uncertain

must take place. To the extent that a moratorium sends a "signal," it is important to assess whether the intended signal is sent to the appropriate parties.

b. Three types of foreclosure moratoria are considered.
   1. *Voluntary nonforeclosure*. This is a voluntary agreement by lenders to refrain from foreclosure proceedings for a certain period of time. The agreement is not legally binding, but a "good faith" attempt on the part of the lenders to involve their customers in seeking financial alternatives other than foreclosure. The consequent legal and economic effects depend upon lender compliance. A voluntary nonforeclosure involves little government action.
   2. *Conditional moratorium*. An objective of a condi-

tional moratorium is to place restrictions on a lender's ability to foreclose. A conditional moratorium may be structured such that conditions other than nonrepayment be met before a stay on foreclosure proceedings can occur. A conditional moratorium might encourage lenders and borrowers to cooperate in investigating alternatives to foreclosure.

3. *Mandatory moratorium.* A mandatory moratorium is a legally binding action which requires lenders to stop all foreclosure proceedings. Unlike a conditional moratorium, no preconditions are involved. A mandatory moratorium must be put in place either through legislative action or by executive order.

II. Foreclosure Moratorium History

a. Foreclosure Moratoria in Minnesota, 1930's.

On February 23, 1933 Governor Floyd B. Olson issued a proclamation halting all mortgage sales until May 1, justifying his actions on the grounds [sic] that violence threatened the state. Confusion over its application resulted. Legislative action followed in the form of a mortgage moratorium law. This law provided for the postponement of certain real estate mortgage foreclosure sales and validating the acts of sheriffs in postponing certain real estate mortgage foreclosure sales; (Chapter 44—H.F. 1779). The moratorium period was not to exceed ninety days.

b. Frazier-Lemke Act of the 1930's (Sec. 75(s), Chapter VIII, U.S. Bankruptcy Laws: Provisions of Relief of Debtors).

Foreclosure moratoria applied under the Frazier-Lemke Act pertained only to farm real estate loans. Under this Act, a farm was appraised by the court and a three year moratorium was granted. The farmer maintained possession of the property, paid rent for its use, and continued to farm. Within three years the farmer could pay the appraised value and redeem the property. If not redeemed it was sold. The farmer was not held liable for loan amounts greater than the lesser of the appraised value or its sale price. The Act gave courts the power to force creditors and borrowers to work out their differences. Relatively few farmers used the provisions of the Act. Those who used it did so only when they thought they had assets worth saving. Use generally increased as general economic conditions improved (Munger and Feder, 1943).

c. 1983—Minnesota Mortgage and Contract for Deed Moratorium Act (Minn. Stat. Ch. 583, 1983).
This law permits mortgagors of residential or agricultural homesteaded property to petition the district court to postpone foreclosure proceedings for up to six months on residential property, or up to twelve months on agricultural property. A contract for deed holder may request that contract termination be delayed up to 90 days.
The court may consider the following criteria in deciding whether to delay the sale or foreclosure:
(1) that the petitioner is unemployed, underemployed or facing economic problems due to low commodity prices; and/or
(2) that the petitioner has an inability to make payments on the mortgage or contract for deed.
The law applies only to first mortgages. It does not apply to mortgages or contracts for deed made after May 24, 1983 or those made before May 24, 1983, for a period longer than one year, or to mortgages or contracts for deed if a second or subsequent mortgage is made against the property after May 24, 1983.

d. 1984 Mortgage Moratorium Extension (Minn. Stat. Ch. 583, 1984).
This action extended the 1983 Minnesota Mortgage and Contract for Deed Moratorium Act. Provisions of the law scheduled to expire May 1, 1984 were extended to May 1, 1985.

e. 1985 Extension of Existing Foreclosure Protection (Minn. Stat. Ch. 583, 1985).
The provisions of the Minnesota Mortgage and Contract for Deed Moratorium Act were again extended. The expiration date of the existing law is extended for two years, from July 1, 1985 to August 1, 1987.

f. Voluntary Moratorium on Minnesota Farm-Loan Foreclosures.
A voluntary moratorium on farm real estate foreclosure was put into place on November 28, 1985. Lender groups calling for the voluntary action included the Independent Bankers of Minnesota, the Minnesota Bankers Association, Norwest Banks, First Bank Systems, and Farm Credit Services. The Farmers Home Administration did not participate. The voluntary agreement is not legally

binding. Lenders are urged to participate and refrain from foreclosure proceedings until the end of February 1986 (a 90-day period). The voluntary moratorium covers only farm real estate loans and does not cover operating or nonreal loans on chattel. During the 90-day period, voluntary mediators will work with borrowers and their lenders to assess the situation and seek alternatives to foreclosure.

III. 1985-86 Foreclosure Moratorium Proposals

a. Mortgage Foreclosure Moratorium, the Berg Proposal (Senate, State of Minnesota, S.F. 85).

This bill was to prohibit farm mortgage foreclosures and foreclosure sales on agricultural land for one year, and to prohibit repossession, foreclosure, and foreclosure sales on agricultural personal property for one year. The moratorium would cover agricultural production real estate, security interests in agricultural crops and livestock, and all personal property used for agricultural production. Repossession, foreclosure, or sale could not take place for one year unless 1) the debtor agreed in writing, or 2) the action followed a court order.

The party to the mortgage or security interest could petition the U.S. District Court and show why the repossession, foreclosure, or sale should proceed. If the court ruled that the action should proceed, it could postpone the repossession, foreclosure, or sale for up to one year if it found:

(1) that a mortgagor or debtor was unable under all reasonable circumstances to make payments; and
(2) that there was reasonable prospect that postponement would enable the mortgagor or debtor to recover and continue farming into the foreseeable future.

The proposal also included a stipulation requiring 5 other states first to pass foreclosure moratorium legislation. Berg's proposal passed the Senate but was defeated by the House.

The Berg proposal was eventually attached to another proposal introduced by Dicklich and Johnson (Senate, State of Minnesota, S.F. 77), which was also defeated.

b. Independent-Republican Senate Caucus Plan (November 12, 1985). (Included as part of an eight-point program). The IR caucus proposes a three-month moratorium on foreclosure of agricultural property to be imposed by the legislature. That legislation would provide that the moratorium may be extended for four consecutive three-month periods, up to a total of 15 months. The extension would be by gubernatorial declaration at the time the then-current moratorium expires. The Governor could declare extensions of the moratorium, taking into consideration whether:

(1) farm land values had stabilized;
(2) farmers and lenders were making reasonable efforts to restructure debt obligations or utilize alternative financing;
(3) the moratorium was having a substantially negative impact on the availability of credit in the farming community; and
(4) appropriate federal action had been taken.

The moratorium would apply to mortgages on agricultural property, but not contracts for deed.

c. Humphrey Proposal, 'Farmer-Lender Mediation Act.'

The Humphrey proposal would establish a Farmer-Lender Mediation Commission, made up of the Commissioners of Agriculture, Commerce, and Finance, and three-person Farm Mediation Boards in each of eleven administrative regions in Minnesota.

Under the proposal, voluntary and mandatory mediation between farm borrowers and their lenders would take place in front of the Mediation Boards. Borrowers or lenders could petition the Commission for voluntary mediation. Mandatory mediation would be required when a lender sought to initiate proceedings against agricultural property for a mortgage foreclosure, termination of contract for deed, or repossession of property. If no agreement was reached, the Board must recommend to the Mediation Commission whether to postpone the lender's actions. If postponement is ordered, the lenders can not take any further action against the borrower for up to one year. If no postponement is ordered, the lender may begin the foreclosure or other proceedings.

If postponement is ordered, the Board would have thirty days to develop a financial plan requiring Commission approval. Postponement could be rescinded if the borrower does not cooperate with the financial plan.

d. Proposal by Senator Moe (Speech November 16, 1985 to Independent Bankers Association).

Senator Moe [of the Minnesota Legislature] proposed a

90-day moratorium, through executive order by the Governor. It would apply to all foreclosures affecting farm operations. If the courts later ruled that such an order requires legislative action, he would then ask the Governor to call a special session to seek necessary approval. Moe did not recommend a roll-over option for renewal. He also recommended that the legislature develop and implement a more long range solution in the next regular session.

IV. Issues Relevant to a Foreclosure Moratorium in Minnesota

a. *Historical evidence.* In the 1930's foreclosure moratoria were imposed in 25 states, including Minnesota. Subsequent analysis has shown that these actions resulted in significantly restricted access to farm credit, as lenders tightened credit eligibility requirements and "rationed" credit to selected customers previously deemed creditworthy (Alston, 1984). No significant change in interest costs was found (Alston, 1984). The moratoria postponed some foreclosures but most likely stopped very few (Perkins, 1969, Woodruff, 1937). The average annual effects of Agricultural Adjustment Act (AAA) programs, federal credit programs, and state moratoria legislation during the period 1933-40 have been estimated by Rucker and Alston (1985). State moratorium legislation was found to be less effective in reducing farm failures than AAA and federal credit programs.

b. *Coverage.* Should a moratorium cover farm real estate, nonfarm real estate, contracts for deed, and other assets, or only some of these? Should it apply to the entire agriculture sector or just to farmers? Should it cover all farmers or only selected farmers? Should coverage depend on the type of debt? Should the moratorium be mandatory, conditional, or a voluntary nonforeclosure?

c. *Economic impact on lenders.* A conditional or mandatory moratorium prevents lenders from exercising some or all of their rights to liquidate collateral. In a voluntary nonforeclosure lenders typically agree not to exercise their right to foreclose.

A lender's inability to liquidate collateral results in foregone income. There is an opportunity cost associated with this inability to reinvest those funds and obtain a higher return. Foregone income reduces gross earnings and profits. Reduced earnings may reduce the equity capital of the lender if losses are realized or if agricultural losses are not offset by interest income on other loans or investments.

A lender may realize unanticipated capital losses if the market value of collateral falls below the outstanding loan principal. A foreclosure moratorium during a period of declining asset values is expected to increase capital losses of farm lenders. Since composition of the capital base and provisions for loss sharing differ between commercial banks and Farm Credit Services, the effects of capital losses on lenders will vary. Eventually, capital losses will be passed on to borrowers. Additionally, banks differ in their levels of capitalization and would likely differ in the level of risk exposure. The inability of lenders to liquidate collateral assets and the potential for reduction in capital would make lenders (particularly commercial banks heavily involved in agriculture) more vulnerable to financial failure.

d. *Economic impact on borrowers*. The impact of a foreclosure moratorium on borrowers is reflected in interest costs, credit availability, and credit redistribution.

   1. *Interest costs*. Although foreclosure moratoria of the 1930's were found to have no significant effects on interest rates (Alston, 1984), circumstances today differ from those of the 1930's. There is sufficient evidence about the magnitude of interest cost effects. Movement from a mandatory moratorium towards a conditional moratorium or voluntary nonforeclosure is likely to reduce upward pressure on interest costs, especially for high-risk borrowers.
   2. *Credit availability*. A distinction should be drawn between farm and rural nonfarm sectors when considering the impact of a moratorium on credit availability. The rural nonfarm sector could expect some additional credit availability if funds are transferred out of the farm sector but not out of rural areas. A voluntary nonforeclosure will likely have little impact on credit availability. Either a conditional or mandatory moratorium is expected to reduce credit availability to the farm sector and increase it to the rural nonfarm sector. Previous experience indicates that a lender's expectation of further moratorium actions and potential applications to other forms of debt (e.g., nonreal estate loans) will result in a decrease in credit available to the farm sector (Alston, 1984).

3. *Credit redistribution*. Given the current financial situation, lenders will likely reevaluate each problem borrower's repayment capacity in an effort to reduce future delinquencies. Farm loan eligibility requirements will also likely change. Credit will be redistributed based on the lender's reevaluation. Some marginal borrowers would become ineligible for additional credit (Alston, 1984). Movement from a voluntary nonforeclosure to a conditional or mandatory moratorium will accelerate a redistribution of credit away from high-risk farm borrowers.

e. *Economic impact on land markets*. The impact of a foreclosure moratorium on land markets is uncertain. A mandatory moratorium is expected to hold some real estate off the market (primarily "forced sales" or disposal of additional acquired properties). Effective demand for farm land is currently quite low, and unlikely to be appreciably affected by a moratorium. Due to this condition land prices may not be changed by relatively small adjustments in supply.

f. *Impact on lender/borrower relations*. A mandatory foreclosure moratorium is likely to lead to deterioration in relations between selected lenders and borrowers. With a conditional moratorium, the courts may require lenders and borrowers to investigate alternatives to foreclosure. A voluntary nonforeclosure (like the one just initiated in Minnesota) creates incentives for borrowers and lenders to work toward alternatives to foreclosure.
Both conditional and mandatory moratoria are likely to increase court costs because of the additional legal proceedings involved (Harl, et al., 1985).

g. *Effects of "buying time"*. A foreclosure moratorium may be a measure to buy time until financial conditions improve or other action is taken (through state legislation, executive order, or federal intervention). This outcome depends critically on a quick turnaround in the agricultural economy (see Boehlje, 1985, FAPRI, 1985 and Runge, 1985). A voluntary nonforeclosure or conditional moratorium may produce some success in "buying time" if lenders and borrowers can develop alternatives to foreclosure during the moratorium. A mandatory moratorium does not facilitate the working out of alternatives.

h. *Other impacts*.

1. *Anticipatory foreclosures*: A mandatory moratorium,

if anticipated, may stimulate increased foreclosures as lenders seek to "get in under the wire." This would not be the case with a voluntary action since lenders retain the right to foreclose. One important question involves whether the foreclosure moratorium would apply to all foreclosure actions or only to those which would have been initiated during the moratorium period.

2. *Lifting the moratorium.* If no other action has been taken, or economic conditions have not sufficiently improved, some foreclosures may have been averted, but many will have only been postponed. If a debt reduction program were initiated during the moratorium, financial adjustments may have taken place and some foreclosures would have been averted.
3. *Legal aspects.* Voluntary nonforeclosure involves few legal questions, since no public action is required. Both conditional and mandatory moratoria involve complicated legal issues. These issues include the constitutionality of a moratorium and its relation to other aspects, such as banking regulations. Another issue arises as to whether the moratorium applies to FmHA and Farm Credit Service loans.
4. *Compatability with other actions.* A foreclosure moratorium must be compatible with other policy interventions, or its usefulness will be diminished. An example is the use of a mandatory foreclosure moratorium at the same time as an interest rate buy-down. A mandatory moratorium would likely adversely affect the availability, cost, and redistribution of credit. This diminishes the effectiveness of interest rate buy-down programs. (Farm Subcommittee, Economic Crisis Commission, 1985).

APPENDIX 1. Minnesota Statutes 1985

Chapter 541, Limitations of Time, Commencing Actions
541.03 FORECLOSURE OF REAL ESTATE MORTGAGE.

Subdivision 1. Limitation. No action or proceeding to foreclose a real estate mortgage, whether by action or advertisement or otherwise, shall be maintained unless commenced within 15 years from the maturity of the whole of the debt secured by the mortgage, and this limitation shall not be extended by the non-residence of any plaintiff or defendant or any party interested in the land upon which the mortgage is a lien in any action commenced to foreclose such mortgage, nor by reason or any payment made after such maturity, nor by reason of any extension of the time of payment of the mortgage or the debt or obligation thereby secured or any portion thereof, unless such extension shall be in writing and shall have been recorded in the same office in which the original mortgage is recorded, within the limitation period herein provided, or prior to the expiration of any previously recorded extension of such mortgage or debt, nor by reason of any disability of any party interested in the mortgage.

Subd. 2. When time begins to run; commencement of proceedings. The time within which any such action or proceeding may be commenced shall begin to run from the date of such mortgage, unless the time of the maturity of the debt or obligation secured by such mortgage shall be clearly stated in such mortgage. Any action or proceeding to foreclose a real estate mortgage, whether by action, by advertisement, or otherwise, commenced within the period of limitation herein provided, may be prosecuted to completion notwithstanding the expiration of the period of limitation, and proceedings to foreclose a real estate mortgage by advertisement shall be deemed commenced on the date of the first publication of the notice of sale.

History: 1909 c 181 s 1, 2 (9188, 9189)

Chapter 580, Real Estate Mortgages; Foreclosure, Advertisement
580.01 LIMITATION.

Subject to the provisions of section 541.03, any mortgage or real estate containing a power of sale, upon default being made in any condition thereof, may be foreclosed by advertisement.

History: RL s 4457; 1953 c 277 s 1 (9602)

580.02 REQUISITES FOR FORECLOSURE.

To entitle any party to make such foreclosure, it is requisite:

(1) That some default in a condition of such mortgage has occurred, by which the power to sell has become operative;

(2) That no action or proceeding has been instituted at law to recover the debt then remaining secured by such mortgage, or any part thereof, or, if the action or proceeding has been instituted, that the same has been discontinued, or that in execution upon the judgment rendered therein has been returned unsatisfied in whole or in part;

(3) That the mortgage has been recorded and, if it has been assigned, that all assignments thereof have been recorded; provided, that, if the mortgage is upon registered land, it shall be sufficient if the mortgage and all assignments thereof have been duly registered.

History: RL s 4458 (9603)

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